Endless Energy Corporation

2002 ANNUAL REPORT

CORPORATE PROFILE

Endless Energy Corp. is a Canadian junior oil and gas exploration and development company with production in Alberta and British Columbia. Endless Energy is also participating in two major offshore exploration projects near Sable Island, Nova Scotia.

Endless Energy is a prospect generating company that commenced operations in 1997 with a small, dedicated technical team who, combined, have over 400 years of experience in the oil and gas industry.

Common shares of Endless Energy Corp. trade on the TSX Venture Exchange under the symbol EEC.

Contents

Annual General Meeting

The Annual General Meeting of Shareholders will be held on Tuesday, June 17, 2003 at 2:30 p.m. in the Aquitaine Auditorium, 2nd floor, 540-5th Ave SW, Calgary, Alberta. Those shareholders unable to attend are encouraged to complete and return the form of proxy mailed to the shareholders with this annual report.

PRESIDENT'S MESSAGE

The year 2002 was exciting but also disappointing for Endless Energy Corp., marked by our attempt to acquire Nova Scotia Resources Limited. This Crown Corporation was bid on and awarded to us in the fall of last year. We raised the four million dollar acquisition cost, and had the promise of the seventeen and one-half million dollar security deposit for the abandonment of two platforms; however, changing market conditions for our potential partners from October 2002 to February of 2003 prevented us from completing the purchase and achieving our long-term goals. It is not very often that a small company attempts to take over a company ten times its size, but we made a good and almost successful attempt. We have now reorganized our capital sources to bid again for the Nova Scotia company. We will be able to fund all of our future requirements should we be successful. We have learned a great deal as a result of our comprehensive dealings for Nova Scotia Resources Limited and expect that, if successful, the Company will acquire some meaningful offshore operations.

"Endless Energy now holds interests in 25 properties– four in British Columbia 15 in Alberta and 6 in Nova Scotia."

Last year we added 25% of new production in the Sounding Lake, Lochend and Campbell areas of Alberta. This increase offset production declines and the Company exited the year at 65 BOEs, down from 73 BOEs per day at the end of 2001. As of May 2003 we are producing 95 BOE's per day.

Subsequent to year-end, we sold the Sounding Lake property to eliminate our debt. In April this year we added 25 BOEs per day and 8370 gross, 5750 net acres at Pocketknife, British Columbia. As of May 1, 2003 the Company holds interests in 36,000 gross acres and 13,500 net acres. Offshore Nova Scotia, we hold a 0.25% royalty interest in 1.487 million acres.

Endless Energy now has interests in 25 properties – four in British Columbia, 15 in Alberta and 6 in Nova Scotia.

The Company has always made efforts to bring in large additions, either by wildcatting or by acquisitions. Pocketknife has now become our core property in the Western Plains, with visibly good upside. We plan to re-complete the Debolt formation in at least two more wells and perforate the up-hole gas zones in the Baldonnel, Charlie Lake, Halfway and Doig zones.

While there still is some resistance to funding and availability of capital markets for smaller companies, our large inventory of defined projects and corporate ideas should give Endless Energy early access to capital and opportunities for near-term growth. Through this year we may ask the shareholders to consider a number of different alternatives available to the Corporation. These are: the merger with, or acquisition of Endless Energy Corp. by another company, the acquisition by Endless Energy Corp. of another entity, or the underwriting of over 100% of the current issued and outstanding shares of the firm, currently at 12.5 million shares basic and 14 million shares fully diluted. The shareholders best interests and market conditions will motivate Endless Energy's future direction.

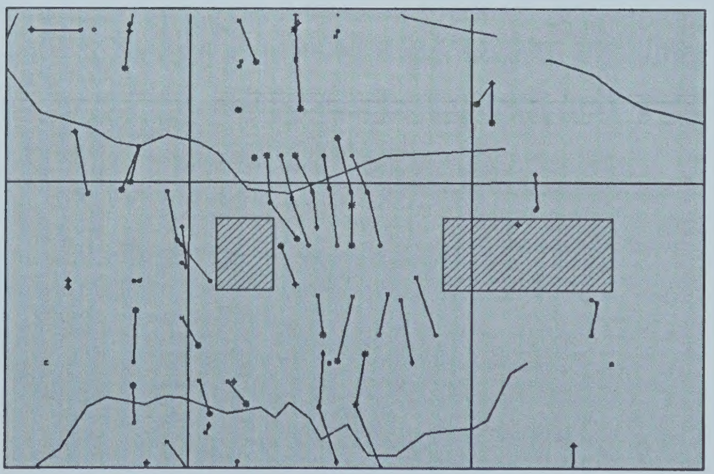
We are a company with a good team of exploration, development, financial and technical experts, an existing inventory of twenty-five prospective properties, and several additional exploration projects.

On behalf of the Board of Directors,

D. Jon Axford
President
May 10, 2003

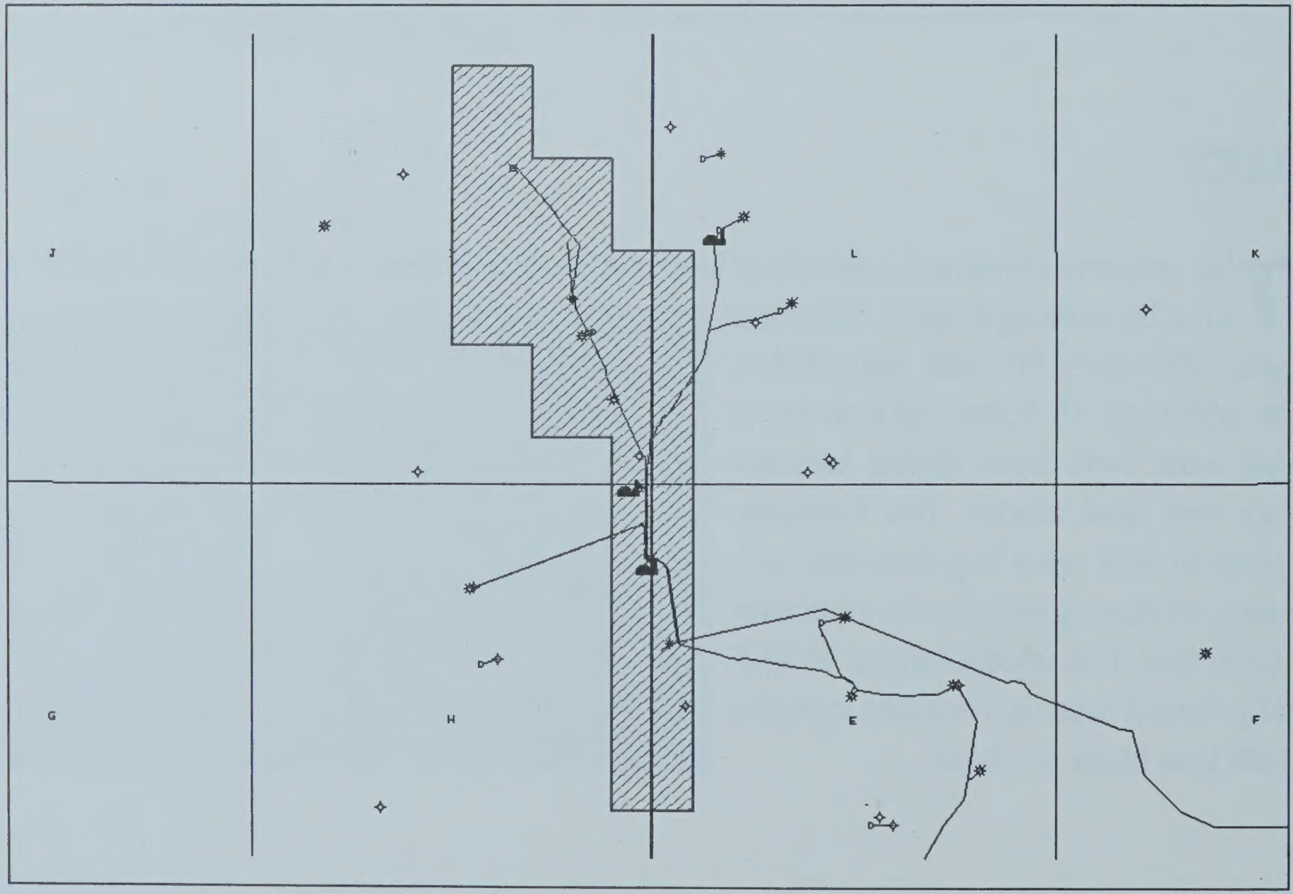
LUCY

This property contains 4 sections of land and Endless Energy is the operator, holding a 66.67% working interest. Since last year when over 90 wells were drilled, an additional 15 horizontal Jean Marie gas wells have been drilled between our two land blocks. The Company plans to farm out a Keg River test well, using an existing well-bore to slant over 1200 feet. This wildcat targets 10 BCF of potential reserves, but also contains infill Jean Marie locations.



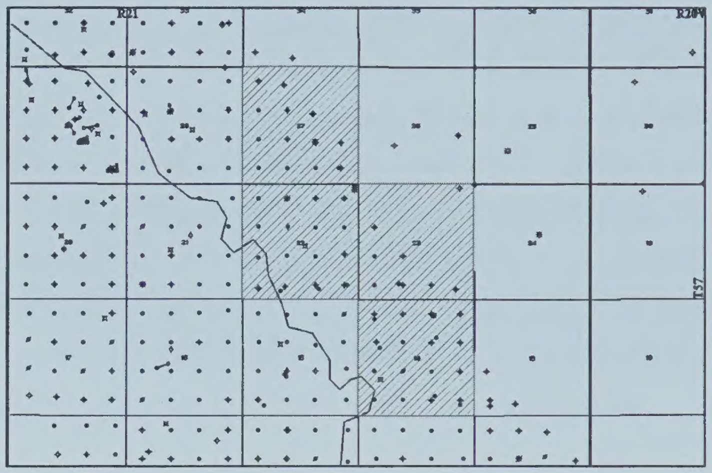
POCKETKNIFE

This property, southwest of the Tommy Lake field in northeastern British Columbia, is located just two miles off the Alaska highway. This field is a naturally fractured Debolt sweet gas pool. Discovered in 1964, the field has produced over 45 BCF of gas. The Company owns and operates a 62.5% working interest, (December 31, 2002 working interest was 37.5%) in one well, producing 500 thousand cubic feet per day (52BOEs/day net) and 100% of 100 thousand cubic feet per day (16 BOE's/day). Three shut-in wells are available for re-works and there exist multiple up-hole zones never tested. This property has two single-well plants owned by the Company and one salt-water disposal facility.



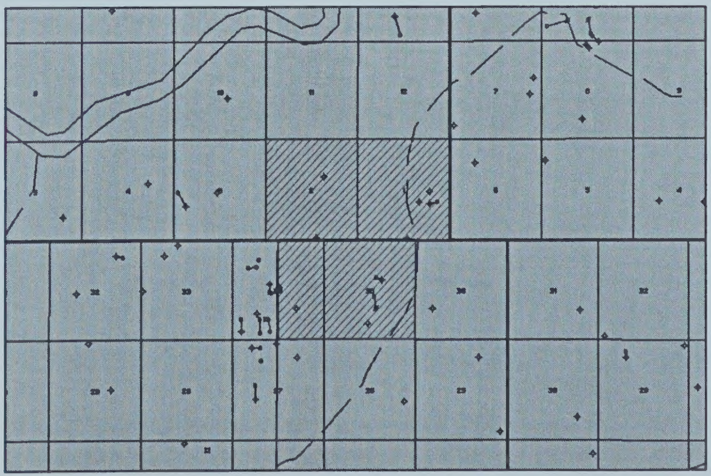
REDWATER

We were unsuccessful last year in our re-work of the Viking formation. We will make one more attempt to re-complete this well, separating the two Viking zones we perforated. It is our belief that one of these zones is contributing gas and the other is giving us water production, which lags our gas. We have one deep wildcat opportunity which we intend to farm out. Endless Energy owns a 35% to 50% working interest in these lands and is the operator.



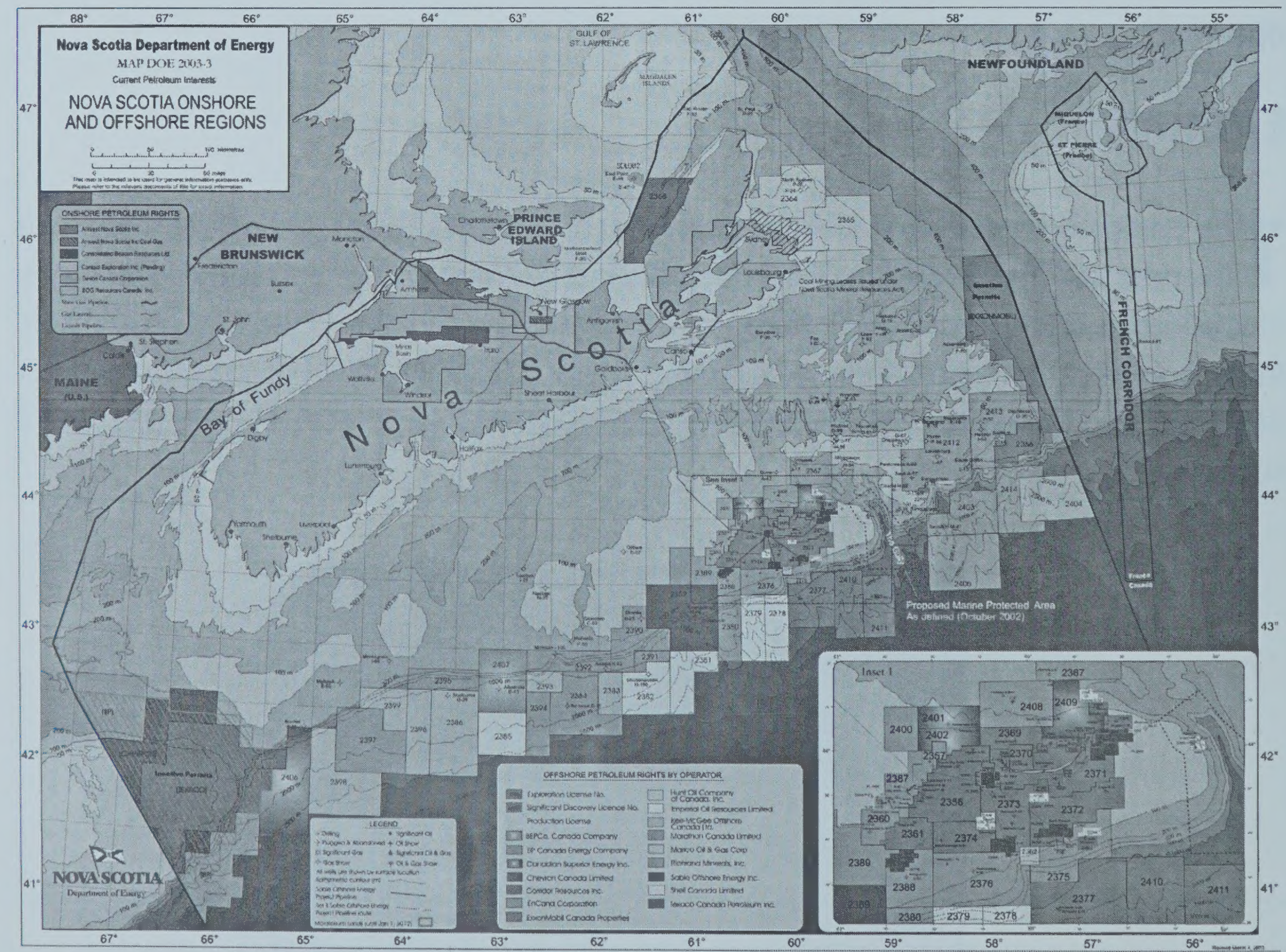
ENCHANT

The Company owns a 45% working interest in three and one-half sections of land and is the operator. The target is a Glauconitic channel oil sand and several up-hole gas zones. This wildcat is analogous to the 5 million barrel oil pool lying 4 miles to the west. In addition, there is an Arcs formation anomaly targeting 2 BCF of gas. All of these targets are under 3000 feet and therefore relatively inexpensive to drill, with good development potential if successful.



SABLE ISLAND

Endless Energy owns a 0.25% gross overriding royalty on over 1.5 million acres offshore Nova Scotia. These properties are comprised of six licenses, two of which are in shallow water and four in deep water. Last summer the operator drilled a dry hole on the shallow water license, targeting a Jurassic reef similar to the Deep Panuke field discovered by Encana. They have announced plans to re-drill a well on this block either later this year or early in 2004. On the deep-water plays, the government of Nova Scotia has announced that the operator is looking to drill a well on or beside our acreages. It is anticipated to spud mid to late 2004. These are turbidite sands (underwater landslides), which are prolific producers in Brazil and the Gulf of Mexico.



The Campbell property, which was producing 7.5 BOEs per day from one well, was successfully drilled, resulting in an oil and gas well in which the Company owns a 10% working interest in the oil and a 20% working interest in the gas. Several offset locations for oil are available and two exploratory locations still exist for deeper targets. The Company owns 10% to 95% working interests on 2680 acres on this operated and non-operated property.

The Acadia property, located 130 miles east of Calgary, has one development location which we expect will be drilled in August of this year. Endless Energy owns a 42.5% working interest and is the operator. It targets gas in the Viking formation. Two other up-hole zones have potential. One dry hole was drilled last year with the Company participating for a 10% working interest.

"Our Volmer property is a Leduc pinnacle prospect with up-hole gas bailouts."

The Sounding Lake property had three reworks completed last year, one for the Colony gas, which briefly boosted our production to over 100 BOEs per day. Although the zone was short lived, production revenue for this rework exceeded expenses and the oil re-works on two oil wells in the Cummings formation also paid for themselves. We decided early this year to sell this property to reduce our debt and it was replaced by the Pocketknife additions we made in April of this year.

Our Volmer property is a Leduc pinnacle prospect, with up-hole gas bailouts. This prospect is just north of the Campbell property and has potential for gas production in the Ellerslie formation and oil in the Leduc formation. The Company owns a 100% working interest. We have recently entered into a three-dimensional seismic option agreement with a private company. The Leduc test well, if elected to be drilled, would leave the Company with a 40% working interest after payout.

Management Discussion and Analysis

The following discussion and analysis should be read in conjunction with the financial statements and the accompanying notes.

Much of the prospective information and forward-looking statements are located in the Presidents' message in this report.

Cash on hand at year-end was $97,000 compared with $762,000 the previous year. The

Company entered into flow-through and common share agreements at year-end 2001, and we spent the funds on development and exploration expenses. Capital assets are $938,000 compared with $1,832,000 in 2001. The Company has taken a ceiling test write down of $902,000 in 2002. Net present value using the discounted cash flows at 15% and using constant pricing is $1,541,000 for proven and probable reserves. Price forecasts used this year are $35.00 US per barrel for oil and $4.40 US per mcf for gas. Last year's forecasts were prepared based on $20.00 US per barrel (75% higher than last year) and $2.53 per mcf (74% higher than last year).

Depletion has increased from $814,000 in 2001 to $1,299,000 in 2002. Included in this amount is the ceiling test write down of $902,000 (2001 - $465,000). Total current liabilities are $831,000 in 2002 compared with the previous year of $781,000. The current liabilities in 2002 include the loan of $284,000, which has been paid off through the sale of Sounding Lake. Shareholders' equity is $5,332,000 in 2002 compared with $1,922,000 for the year 2001. Included in the 2002 amount are the escrowed shares, which were issued for a consideration of $4,875,000, which are being cancelled subsequent to December 31, 2002. Revenue decreased by 37% from $691,000 in 2001 to $501,000 in 2002. The decrease is due to less production revenue from Pocketknife.

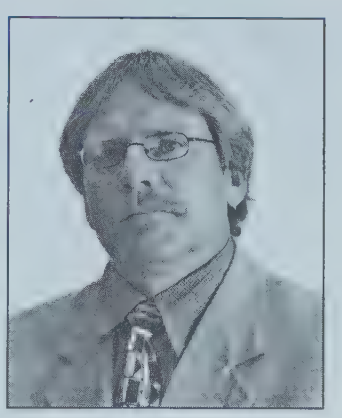
"General and administrative expenses increased 24% to $527,000 this year from $425,000 a year ago."

General and Administrative expenses increased 24% to $527,000 this year from $425,000 a year ago. Acquisition costs and increasing administration of the assets account for the difference. Endless Energy's production at year-end reduced by 11% from 73 BOE's per day to 65 BOE's per day. Average price received for oil was $21.64 per barrel during 2002 as compared to $34.10 per barrel in 2001. Average gas price received during 2002 was $3.39 per mcf as compared to $5.21 per mcf in 2001.

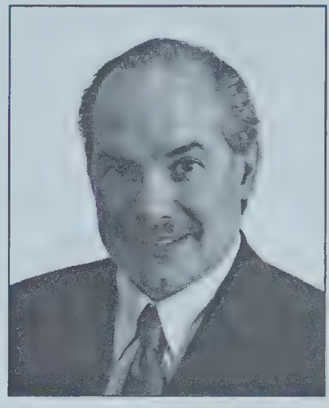
The outlook for the Company is uncertain at this time. We are awaiting the decision of whether any assets will be purchased from the Province of Nova Scotia. In addition, market conditions and the availability of capital will determine which direction Endless Energy takes, and will be determined by the time our Annual General and Special Meeting of the Shareholders occurs which is June 17th at 2.30 pm in the Acquitaine Auditorium on the second floor of 540 5th Ave. S.W. Calgary Alberta T2P 0M2.

PERSONNEL

D. Jon Axford
Director, President, CEO



W. Kevin Dickson
Vice President Production



Larry S. Martin, CA
Chief Financial Officer

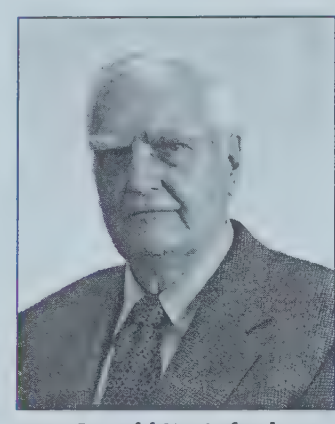
William H. Smith, Q.C., LLB
Corporate Secretary

Barb Goodwin
Administrative Assistant

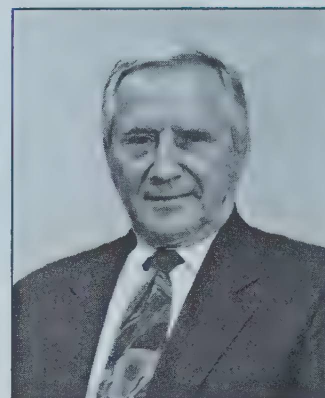
Rosemary Kumlin
Accountant

Howard Walls
Gas Marketing

PERSONNEL

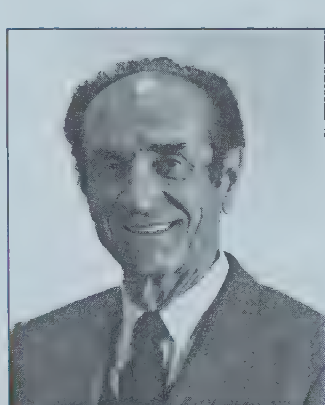


Donald W. Axford
Director, Chief Geologist

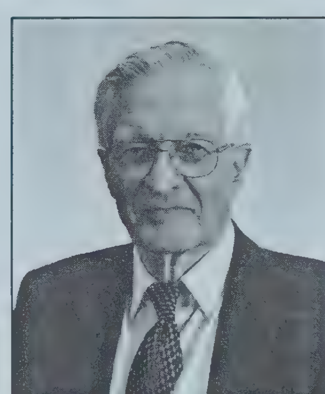


Byron J. Seaman
Director

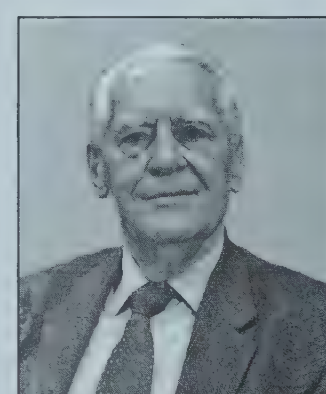
Victor Skurat, MBA
Director, Corporate Finance



John Andrichuck
Exploration



Ralph Edie
Exploration



Oscar Erdman
Exploration

MANAGEMENT'S REPORT

The management of Endless Energy Corp. is responsible for the preparation of the accompanying financial statements and all other information contained in this annual report. The consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada and according to the policies detailed in the notes.

The company maintains an appropriate system of internal controls to provide reasonable assurance that assets are properly safeguarded and the financial records are sufficiently well maintained to provide relevant, timely and reliable information to management.

Hudson and Company LLP, an independent firm of chartered accountants, has examined the financial statements and has provided a professional opinion on them, based on generally accepted auditing standards.

An Audit Committee of the Board of Directors has reviewed these consolidated financial statements with management and the external auditors. The Board of Directors has approved the financial statements based on the recommendation of the Audit Committee.

D. Jon Axford
President and Director

May 10, 2003

AUDITORS' REPORT

To: The Shareholders of
Endless Energy Corporation

We have audited the consolidated balance sheets of **Endless Energy Corporation** (the "Company") as at December 31, 2002 and 2001 and the consolidated statements of operations and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

signed "Hudson & Company LLP"

Calgary, Alberta
May 14, 2003

HUDSON & COMPANY LLP
Chartered Accountants

ENDLESS ENERGY CORPORATION
CONSOLIDATED BALANCE SHEETS

DECEMBER 31	2002	2001
ASSETS		
CURRENT		
Cash	$ 97,318	$ 762,042
Accounts receivable	181,804	133,683
Prepaid expenses	28,736	40,748
	307,858	936,473
CAPITAL ASSETS (Note 5)	938,604	1,832,296
WELL ABANDONMENT DEPOSITS (Note 6)	84,888	-
RESTRICTED CASH (Notes 9(c) and 14)	4,875,000	-
	$ 6,206,350	$ 2,768,769
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities (Note 8)	$ 546,736	$ 518,099
Note payable (Note 7)	283,893	262,675
	830,629	780,774
FUTURE INCOME TAXES	-	40,872
SITE RESTORATION	43,700	24,700
	874,329	846,346
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 9)	7,815,041	2,429,528
DEFICIT	(2,483,020)	(507,105)
	5,332,021	1,922,423
	$ 6,206,350	$ 2,768,769

FUTURE OPERATIONS (Note 2)

Contingent liabilities (Note 10)

Approved On Behalf Of The Board

D. Jon Axford
Director

Victor Skurat
Director

ENDLESS ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

YEARS ENDED DECEMBER 31	2002	2001
REVENUE		
Petroleum and natural gas, net of royalties	$ 501,532	$ 691,110
Interest income	4,607	877
	506,139	691,987
EXPENSES		
Amortization and depletion	1,299,400	814,000
General and administrative	526,752	425,056
Operating	164,413	295,818
Interest on promissory note	26,281	12,918
Site restoration	19,000	20,700
	2,035,846	1,568,492
LOSS FROM OPERATIONS	(1,529,707)	(876,505)
OTHER INCOME (EXPENSE)		
Costs of failed acquisition (Note 16)	(516,209)	-
LOSS BEFORE INCOME TAXES	(2,045,916)	(876,505)
INCOME TAX RECOVERY (Note 11)		
Current	(12,329)	-
Future	(57,672)	(415,699)
	(70,001)	(415,699)
LOSS	(1,975,915)	(460,806)
DEFICIT, beginning of year	(507,105)	(46,299)
DEFICIT, end of year	$ (2,483,020)	$ (507,105)
BASIC AND DILUTED LOSS PER SHARE (Note 12)	$ (0.172)	$ (0.066)

ENDLESS ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss	$ (1,975,915)	$ (460,806)
Items not affecting cash:		
Amortization and depletion	1,299,400	814,000
Future income taxes	(57,672)	(415,699)
Site restoration	19,000	20,700
	(715,187)	(41,805)
Change in non-cash working capital items (Note 13)	(126,353)	(52,647)
	(841,540)	(94,452)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of capital assets	(293,196)	(49,111)
Well abandonment deposits	(84,888)	-
	(378,084)	(49,111)
CASH FLOWS FROM FINANCING ACTIVITIES		
Purchase of Valkyrie Resources Inc., net of cash assumed on purchase	-	(104,995)
Share issuance costs	(10,000)	(57,879)
Increase in restricted cash	(4,875,000)	-
Issuance of share capital	5,439,900	1,032,742
	554,900	869,868
INCREASE (DECREASE) IN CASH	(664,724)	726,305
CASH, beginning of year	762,042	35,737
CASH, end of year	$ 97,318	$ 762,042
CASH CONSISTS OF:		
Cash	$ 97,318	$ -
Bank indebtedness	-	(45,669)
Cash held in trust	-	807,711
	$ 97,318	$ 762,042

OTHER INFORMATION (Note 13)

ENDLESS ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2002 AND 2001

1. NATURE OF OPERATIONS

Endless Energy Corporation was incorporated under the Business Corporations Act of Alberta on March 27, 1997. On May 31, 2002 the Company was amalgamated with its wholly owned subsidiary Valkyrie Resources Inc. under the Business Corporations Act of Alberta. The Company's principle business is the exploration for and the production of petroleum and natural gas reserves in Western Canada.

2. FUTURE OPERATIONS

As at December 31, 2002, the Company had a working capital deficit of $522,771 and incurred losses of $1,975,915 and $460,806 in the last two years.

The Company's ability to continue operations is dependent on its ability to attain profitable operations or to obtain additional financing.

These financial statements have been prepared on a going concern basis which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due.

The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

ENDLESS ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2002 AND 2001

3. ACQUISITION

On July 3, 2001, the Company acquired 100 percent of the outstanding common shares of Valkyrie Resources Inc. The aggregate purchase price was $650,000, including $160,000 cash, 400,000 common shares of the Company valued at $100,000, and promissory notes in the amounts of $390,000. The results of Valkyrie's operations have been included in the consolidated financial statements since July 3, 2001.

The following summarizes the fair value of the net assets acquired and the consideration given.

Fair value of net assets acquired:		
Current assets	$	147,515
Petroleum and natural gas properties and equipment		801,459
Current liabilities		(61,524)
Future income taxes liability		(237,450)
	$	650,000
Consideration given:		
Cash	$	160,000
Promissory notes		390,000
Share capital		100,000
	$	650,000

During the current year, Valkyrie Resources Inc. was amalgamated with the Company as noted in Note 1.

4. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared using the historical cost basis in accordance with Canadian generally accepted accounting principles. These financial statements have, in management's opinion, been properly prepared within the framework of the accounting policies summarized as follows:

ENDLESS ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2002 AND 2001

4. SIGNIFICANT ACCOUNTING POLICIES, continued

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. By their nature, these estimates are subject to measurement uncertainty. Accounts specifically affected by estimates in these financial statements are the amounts recorded for the provision for amortization and depletion of the petroleum and natural gas properties and the provision for site restoration. These are based on estimates of reserves and future costs. The ceiling test calculation is based on estimates of proven reserves, production rates, petroleum and natural gas prices, future costs and other applicable factors. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of future years could be material.

Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, 853926 Alberta Ltd. and Valkyrie Resources Inc, which amalgamated with the Company on May 31, 2002. All intercompany balances have been eliminated on consolidation.

Cash and cash equivalents

Cash consists of balances on hand with banks and trust accounts.

Joint ventures

Substantially all of the Company's petroleum and natural gas activities are conducted jointly with others and accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

Capitalized costs

The Company follows the full cost method of accounting whereby all costs related to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized in a Canadian cost centre and charged against income as discussed below. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals on non-productive properties, cost of drilling both productive and non-productive wells, equipment costs and general and administrative expenses applicable to these activities.

Gains or losses on sales of properties are recognized only when crediting the proceeds to costs would result in a change of 20 percent or more in the amortization and depletion rate.

ENDLESS ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2002 AND 2001

4. **SIGNIFICANT ACCOUNTING POLICIES, continued**

Amortization and depletion

Amortization and depletion of petroleum and natural gas properties and equipment is provided for using the unit-of-production method based on estimated proven petroleum and natural gas reserves before any royalty deductions as determined by independent engineers. For the purpose of this calculation, petroleum and natural gas reserves are converted to a common unit of measurement on the basis of their relative energy content where six thousand cubic feet of gas equates to one barrel of oil. Costs of acquiring and evaluating unproven properties are excluded from costs subject to amortization and depletion until it is determined whether proven reserves are attributable to the properties or impairment occurs.

Computer equipment is recorded at cost and is amortized using the declining balance method at the annual rate of 30%.

Ceiling test

The Company applies a ceiling test to capitalized costs to ensure that the net carrying value of petroleum and natural gas properties does not exceed the estimated value of future net revenues (calculated using year end prices) from the production of proven reserves, plus the costs of unproven properties (net of impairment) less related general and administrative, financing costs, estimated future major development and site restoration costs and income taxes. Any impairment in value is charged to operations.

Site restoration

The estimated costs of future removal and site restoration of petroleum and natural gas properties are provided for on the unit-of-production method. The annual charge is made to site restoration expense and actual site restoration expenses will be charged to the accumulated future site restoration account as incurred.

Stock-based compensation

The Company has a stock-based compensation plan, which is described in Note 9. Effective January 1, 2002 a new accounting standard for stock-based compensation plans was prospectively adopted and applied to awards granted subsequent to the date of adoption. The Company's stock-based compensation plan for employees does not involve the direct award of stock, or call for the settlement in cash or other assets. As a result, the Company has the option to apply either the intrinsic value based method or the fair value based method of accounting for stock-based compensation awards granted to employees. For awards of stock options to non-employees, the Company is required to expense the fair value for each award. Any consideration paid by employees on exercise of stock options or purchase of stock is credited to share capital.

The Company has elected to apply the intrinsic value based method for accounting for employee stock options and accordingly, no compensation costs have been recognized in the financial statements.

ENDLESS ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2002 AND 2001

4. **SIGNIFICANT ACCOUNTING POLICIES, continued**

Earnings per share

Basic earnings (loss) per common share are calculated using the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share are calculated using the treasury stock method for determining the dilutive effects of options.

Flow through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow through share arrangements are renounced to investors in accordance with tax legislation. A future tax liability is generated upon the issuance of such shares. The liability is reduced when the related expenditures are incurred.

Future income taxes

The Company uses the liability method for estimating future income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities as well as for benefit of losses available to be carried forward to future years for tax purposes that are likely to be realized and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized. Temporary differences arise when, for income tax purposes, the Company deducts exploration and development expenditures and capital cost allowance in amounts differing from those charged as amortization and depletion expense in the financial statements.

ENDLESS ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2002 AND 2001

5. **CAPITAL ASSETS**

	2002			2001
	Cost	Accumulated Amortization and Depletion	Net	Net
Computer equipment	$ 21,396	$ 11,109	$ 10,287	$ 14,687
Petroleum and natural gas properties and equipment	3,461,148	2,532,831	928,317	1,817,609
	$ 3,482,544	$ 2,543,940	$ 938,604	$ 1,832,296

During the year the Corporation wrote down its petroleum and natural gas properties by $902,000 (2001 - $465,000), which has been included in the amortization and depletion expense.

Excluded from the depletion calculation of petroleum and natural gas properties and equipment is unproven lands in the amount of $198,000 (2001 - $719,000).

6. **WELL ABANDONMENT DEPOSITS**

Amount consists of funds held in trust to finance future well abandonment costs.

7. **NOTE PAYABLE**

	2002	2001
Promissory note payable with principal balance of $260,000 plus interest accruing at 10% per annum.	$ 283,893	$ 262,675

Subsequent to year end the note was cancelled in exchange for certain petroleum and natural gas properties (Note 15).

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8. DUE TO RELATED PARTIES

During the year, the Company entered into the following transactions with related parties:

A law firm in which the Corporate Secretary is a partner provided legal services in the amount of $130,548 (2001 - $16,946). At December 31, 2002 $119,777 (2001 - $16,324) was owing for their services.

A company owned by a Vice President provided consulting services in the amount of $117,556 (2001 - $77,997). At December 31, 2002, $18,388 (2001 - $23,920) was owing for their services.

These transactions were measured at the exchange amount which is the amount established and agreed to by the parties. The amounts owing by the Company are included in accounts payable and accrued liabilities.

A company owned by a Director owes the Company $18,172 (2001 - $6,636) as a result of cost sharing arrangements. The amount is included in accounts receivable.

9. SHARE CAPITAL

a) Authorized

Unlimited number of common voting shares
Unlimited number of preferred shares, issuable in series

b) Common shares issued

	Number	Amount
Balance December 31, 2000	6,091,824	$ 1,296,786
Flow through shares issued for cash, net of share issuance costs of $132,491 and future income taxes of $364,115.	4,426,525	1,032,742
Shares issued for purchase of Valkyrie Resources Inc.	400,000	100,000
Balance December 31, 2001	10,918,349	2,429,528
Shares issued for cash, net of share issuance costs of $37,587.	1,500,000	487,413
Flow through shares issued for cash, net of future income taxes of $16,800 related thereto.	133,000	23,100
Escrowed shares issued for cash held in trust.	9,750,000	4,875,000
Balance December 31, 2002	22,301,349	$ 7,815,041

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9. **SHARE CAPITAL, continued**

c) Escrowed shares

Pursuant to an escrow agreement dated November 1, 2002, 9,750,000 common shares were being held in escrow with the condition they were to be released on the completion of a share purchase agreement. Subsequent to December 31, 2002, it was determined that the share purchase agreement could not be completed and the Company will be cancelling the shares and refunding the cash received, which was being held in trust.

d) Share option plans

The Company has a stock option plan which allows for the issuance of options to purchase shares at specific prices for a period of time. The maximum number of shares issuable pursuant to options granted under the plan are limited to 10% of the total issued and outstanding common shares subject to shareholder approval. All options under the plan vest immediately. The option price under the plan will not be less than the market price of the common shares on the date of grant. The expiry date for each option will be set by the Board of Directors at the time of issue of the option but in any event will not be more than five years after the grant date.

During the year the Company issued 150,000 share options to employees. The fair value of options granted to employees in the current year (not recorded) is $37,410 using the assumptions of a risk-free interest rate of 5.2%, an expected options life of 5 years, an expected volatility of 270% and expected dividends of nil. Loss and proforma adjustments are presented below:

	2002	Basic and diluted loss per share
Loss as reported	$ (1,975,915)	$ (0.172)
Proforma adjustment	(37,410)	(0.002)
Proforma loss and loss per share	$ (2,013,325)	$ (0.174)

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9. **SHARE CAPITAL, continued**

A summary of the status of the Company's stock option plan as of December 31, 2002 and 2001 and changes in the periods ending on those dates is presented below:

	2002		2001	
	Number of options	Weighted average share price	Number of options	Weighted average share price
Balance, beginning of year	720,000	$0.30	520,000	$0.29
Granted	150,000	0.30	200,000	0.30
Balance, end of year	870,000	$0.30	720,000	$0.30

The following table summarizes information about stock options outstanding at December 31, 2002:

Options outstanding	Exercise price	Options exercisable at December 31, 2002	Expiry date
420,000	$ 0.30	420,000	May 15, 2005
150,000	0.30	150,000	June 26, 2005
150,000	0.30	150,000	May 1, 2006
150,000	0.30	150,000	March 1, 2007
870,000		870,000	

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10. CONTINGENT LIABILITIES

The Company is presently involved in a dispute involving the purchase of certain petroleum and natural gas properties. The vendors of these properties have filed a claim against the Company, in the amount of $185,345, which they contend is owing to them. The Company has recognized a liability in the amount of approximately $66,000 in these financial statements and is negotiating with the vendor to settle this matter. Any additional amounts which the Company may have to pay concerning the purchase of these properties will be reflected in the period of settlement.

The placement agent involved in a failed share placement agreement has filed claims against the Company for $4,840,000 for breaches of Agency and Engagement Agreements. The Company believes that the claims are without merit and consequently no amount has been recorded in the financial statements for this claim. Any amounts which the Company may have to pay with respect to these agreements will be reflected in the period of settlement.

As part of the failed acquisition (Note 16), the vendor of the shares the Company was considering purchasing can demand payments of up to $1,400,000 should the Company decide not to continue with the share purchase. Presently, negotiations are continuing with respect to the share purchase and the amount of payment required to be paid to the vendor, if any, cannot be determined. Any amounts which the Company may have to pay with respect to the failed acquisition will be reflected in the period of settlement.

11. FUTURE INCOME TAXES

a) The components of future income tax balances are as follows:

	2002	2001
Future income tax asset		
Non-capital loss carry-forwards	$ (222,467)	$ (121,734)
Tax basis of capital assets in excess of carrying amount	(242,746)	-
Share issuance costs	(49,721)	(61,782)
Other	(11,475)	(13,860)
Capital loss carryforward	(102,395)	-
Future income tax liability		
Carrying amount of capital assets in excess of tax basis	-	238,248
	(628,804)	40,872
Valuation allowance	628,804	-
	$ -	$ 40,872

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11. **FUTURE INCOME TAXES, continued**

b) The provision for income taxes recorded in the financial statements differs from the amount which would be obtained by applying the statutory income tax rate of 42.1% (2001 - 42.1%) to the loss for the years as follows:

	2002	2001
Loss for the year before income taxes	$ (2,045,916)	$ (876,505)
Anticipated income tax recovery	$ (861,331)	$ (369,009)
Non deductible portion of capital loss	102,395	-
Benefit of income tax losses not recognized	-	(8,951)
Crown charges	7,589	-
Sundry non taxable items	(12,509)	(13,565)
Resource allowance	20,003	(12,551)
Change in income tax rates	-	(11,623)
Valuation allowance	673,852	-
Provision for income taxes	$ (70,001)	$ (415,699)

The Company has the following estimated balances available in its income tax pools to apply against future years taxable earnings:

Cumulative eligible capital	$ 16,692
Undepreciated capital cost	408,945
Canadian development expenses	262,994
Canadian exploration expenses	757,978
Canadian oil and gas property expenses	123,022

For income tax purposes, the Company has losses carried forward from prior years which can be applied to reduce future years' taxable income. These losses expire as follows:

2004	$ 48,834
2005	16,980
2006	46,075
2007	77,400
2008	154,848
2009	230,952
	$ 575,089

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12. EARNINGS PER SHARE

Basic earnings per share is calculated using the weighted average number of shares outstanding during the year. Shares held in escrow have not been included in the calculation of weighted average number of shares as they are deemed contingently issuable. Diluted loss per share has not been calculated as the effect of the stock options outstanding as described in Note 9 is anti-dilutive. Earnings per share is calculated as follows:

	2002			2001		
	Loss	Shares	Earnings per share	Loss	Shares	Earnings per share
Basic and fully diluted	(1,975,915)	11,484,849	(0.172)	(460,806)	6,987,664	(0.066)

13. STATEMENT OF CASH FLOWS

Change in non-cash working capital items

	2002	2001
Accounts receivable	$ (109,189)	$ 177,869
Prepaid expenses	12,012	(29,648)
Accounts payable and accrued liabilities	(29,176)	(200,868)
	$ (126,353)	$ (52,647)

Other information

	2002	2001
Interest paid	$ 13,500	$ 15,829
Income taxes recovered	(12,329)	-

14. RESTRICTED CASH

Restricted cash consisted of amounts held in trust and was intended to be used under the terms of a share purchase agreement which subsequent to December 31, 2002 could not be completed (Notes 9(b) and 9(c)).

15. SUBSEQUENT EVENTS

Subsequent to December 31, 2002, certain petroleum and natural gas properties were sold for the cancellation of the note payable (Note 7). As a result of this transaction, it is anticipated that the change in depletion rate will exceed 20 percent and a gain of $68,544 will be recognized for the year ending December 31, 2003. The transaction will be measured at the amount established and agreed to by the related parties as there is independent evidence available.

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16. COSTS OF FAILED ACQUISITION

During the year the Company entered into a share purchase agreement requiring the payment of a non-refundable deposit of $400,000. The Company was unable to complete the share purchase agreement within a specified time period and consequently forfeited the deposit. Included in the costs are legal and accounting fees of $116,209.

17. FINANCIAL INSTRUMENTS

Financial instruments consist of recorded amounts of accounts receivable which will result in future cash receipts, as well as, accounts payable and accrued liabilities, and note payable which will result in future cash outlays.

a) Credit Risk

Credit risk arises from the potential that a counter party will fail to perform its obligations. The Company is exposed to credit risk from customers. However, the Company has a significant number of customers which minimizes concentration of credit risk.

b) Fair Value

The fair values for accounts receivable, accounts payable and accrued liabilities and note payable approximates their carrying values due to the short term maturity of those instruments.

c) Interest Rate Risk

Interest rate risk arises from the possibility that the value of, or cash flows related to, a financial instrument will fluctuate as a result of changes in market interest rates. The Company is exposed to financial risk that arises from the interest rate differentials between the market interest rate and the rates used on the financial instruments. The note payable bears interest at 10%. The effective interest rate realized during the year was 10% (2001 - 9.5%). The average interest rate was 10% (2001 - 9.4%).

18. CONTRACTUAL OBLIGATION

The Company's total obligation, under various operating leases and a property lease agreement, exclusive of occupancy costs, is as follows:

2003	$ 19,627
2004	13,085
	$ 32,712

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